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Building institutions for achieving the development goals and integrating in the global economy

Report of the Secretary-General

Summary

The General Assembly, in resolution 59/240 of 22 December 2004, recognized the importance of national policies, an enabling international environment and policy coherence for the beneficial integration of countries, particularly developing countries, into a globalizing world economy, and underscored the centrality of institutions as well as institutional coherence in this quest. The present report addresses the institutional dimension of the challenges of integrating into the world economy. The achievement of this integration depends on the attainment of maximum economic growth while at the same time promoting social goals and environmental protection, all complex interrelated issues that require strong institutional mediation.

The need for institutional development and adaptation is an enduring challenge. A narrow view of institutional reforms — especially that focuses only on the role of markets and securing private property rights without due attention to a holistic and optimal development outcome from the point of view of society — may be inadequate. Whereas the role of markets is critical, it needs to be seen within the context of broader societal goals of social equity and environmental sustainability.

The principal challenge facing developing countries is to develop sound institutional foundations for the effective and efficient functioning of markets within the framework of their social and environmental objectives. The right supportive institutional arrangements may vary given the level of development and specific national and regional contexts. This notwithstanding, empirical evidence shows that institution building and strengthening are a vital pursuit in the quest of developing countries for sustainable development and beneficial integration in the global economy.

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A central objective should be to ensure that institutional reforms respond to the needs of the poor as a key priority in poverty-reduction strategies and, indeed, in overall strategies to promote more rapid, broad-based and sustainable growth and development.

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I. Background

1. Integration in the global economy entails a variety of strategic and policy measures and actions. One of the key instruments for deepening integration has been the adoption of different models of market-oriented reforms and openness suitable to each country. The primary expectation arising from this integration is that development will be achieved. Yet, this expectation has not been fulfilled for many developing countries, giving rise to questions about the right circumstances in which beneficial integration takes place.

2. Experience shows that the realization of these goals requires strong institutional underpinning to guide and buttress economic activities and mediate sometimes conflicting interests in the development process. For example, markets cannot function without institutions that support transactions among agents, including the enforcement of contracts. Institutions also help to manage and mediate the competing demands of economic growth, social development and environment protection. At another level, institutions are required to respond to changes in the global economy and the emergence of rule-based international regimes in the area of the environment, finance and trade that impose new obligations on national Governments. In other words, the pursuit of economic growth and development goals in a changing and dynamic global economic environment requires constant institutional adaptation and change to respond to new circumstances. Lastly, for developing countries, economic reforms and restructuring have not always proceeded smoothly. Moreover, the size of their markets and the imperfect flow of information often mean that markets do not operate optimally. All these factors imply a larger role for Governments in bridging gaps that would otherwise stifle the smooth functioning of private social and economic agents. This notwithstanding, the institutional dimension has often been taken for granted in the development strategies of many developing countries, hence the need to revisit the subject in the hope of rekindling activism in the area in the coming years.

3. The General Assembly, in resolution 59/240 of 22 December 2004, recognized the importance of national policies, an enabling international environment and policy coherence for the beneficial integration of countries, particularly developing countries, into a globalizing world economy, and underscored the centrality of institutions as well as institutional coherence in this quest. The present report is intended to address the institutional dimension of the challenges of integrating into the world economy. The achievement of this integration depends on the attainment of maximum economic growth and development while at the same time promoting social goals and environmental protection, all complex interrelated issues that require strong institutional mediation.

II. Introduction

4. The process of globalization and interdependence, engendered by market reforms and openness, has made integration into the world economy imperative. This is particularly true for developing countries, which tend to have large external exposure. Integration in the global economy has also come to be associated with expectation of achieving higher rates of economic growth, through trade expansion and access to foreign direct investments (FDIs) and technology, which are essential for the achievement of the goals of poverty eradication and sustainable

development. In many cases, particularly in Africa and Latin America, the results of efforts at integration, including years of experimentation with economic and political reforms, have fallen short of expectations. There are many factors that have contributed to this outcome, and the lack of appropriate and effective institutions around which economic activity and development can thrive is certainly an important one.

5. Success in establishing institutions that put developing countries on the path to economic growth alone is not sufficient for poverty eradication and sustainable development. Equally necessary are institutions that mediate the goals of social equity and environmental sustainability. There is, however, an emerging consensus that good-quality institutions are important for ensuring the transition to higher productivity, faster growth and sustainable development. In this sense, there is considerable evidence that institutional differences among countries are among the fundamental factors explaining differences in incomes and standards of living across countries.

III. Defining institutions

6. Institutions can be conceived as the organizations rules and social norms, formal or informal, that facilitate human interaction, including those that structure political, economic and social interactions. In the area of economic activities, they include norms, procedures and regulatory frameworks that guide transactions in such areas as finance, trade, investment and technology, and mediate information about markets, their participants and the available goods and services whether at national, regional or global levels. The necessity of translating these rules into policies and the need to implement and enforce them give rise to entities (such as central banks, regulatory agencies), structures (such as pension systems) and arrangements (such as exchange-rate regimes) which can be formal or informal, and public or private.

7. A useful distinction can be made between formal and informal institutions. The former are rules or entities that are determined by public policy or codified. They include constitutions, laws and regulations as well as entities that oversee these rules, ranging from legislatures to the central banks. The latter are widely accepted conventions, codes of conduct or social norms often embedded in the very fabric of society and largely respected voluntarily. Informal institutions are important in that they create certainty and predictability in social and economic transactions where formal rules do not exist. They also create and promote values that would be more difficult to agree upon in more formal settings. In this way, they complement formal institutions and provide the bedrock on which they are built and nurtured.

8. Institutions are also shaped by informal networks. These voluntary networks that either promote existing norms and values or seek to create and advocate different causes and values are assuming increasing importance. The United Nations Global Compact is an example of a non-negotiated institutional innovation that evolved to promote responsible corporate behaviour that asks companies in their practices to embrace 10 principles in the areas of human rights, labour, the environment and anti-corruption. The Compact is an example of how informal

networks can coalesce around existing core values and norms, and effect their practical translation where more formal enforcement would have been very difficult.

9. The form of institutions is important and their quality matters as well. The quality of institutions is usually determined on the basis of factors such as good governance, including the degree of corruption, public sector efficiency and the suitability of regulations; the extent of legal protection and enforcement of property rights, private and public and, in many societies, collective property rights; and the checks and balances imposed on elites, political leaders and other powerful interest groups. These minimum standards of good institutions are deemed necessary to lower the burden of transactions costs on innovation and enterprise, to restrain infringement on the rights and properties of others, and to avoid distortion of incentive structures in society.

10. Throughout history countries have changed their institutions not only to cope with their own development but also to respond to the evolution of regional and global norms and rules (see box 1). This necessity is more evident in the context of

Box 1
The United Nations development agenda and inclusive globalization

The outcomes and commitments of the major United Nations conferences and summits of the 1990s and beyond — the United Nations development agenda that encompasses a broad range of development issues and goals — have become the organizing framework for international cooperation for development. In fact, the Millennium Development Goals, the eight goals that include the commitment of the international community to reduce by half the number of people living in extreme poverty by 2015, have now been adopted by all development institutions as a reference point for their work. This achievement is an apt illustration of how institutions evolve and adapt to changing imperatives. Consensus is emerging that the design of poverty reduction strategies should be Millennium Development Goals-based, a move that will further institutionalize the United Nations development agenda. The internationally agreed development goals are the surest tool for balancing the economic, social and environmental objectives while at the same time promoting inclusive globalization — globalization with a human face.

rapid globalization and interdependence. Strategies to build and strengthen national institutional arrangements should therefore take this factor into account. The importance of the regional and the global dimensions depends on the issue at hand. In the area of trade, the rules agreed upon in the World Trade Organization are negotiated multilaterally, have almost universal application, and are binding. In the area of environment, a number of multilateral agreements have been concluded that also cover a whole range of issues of global concern. In some regions, the desire to expand markets has driven regionalism. Sometimes, a combination of geography, history, culture, interlocking national interests and the need for cooperation dictate regional institutional development. In designing new institutions and strengthening

existing ones, the spatial dimension is therefore important in respect of ensuring that spillover effects and the positive and negative externalities arising from national and local actions and multilateral legislation are considered and internalized.

11. This report uses all these definitional dimensions, and adheres to a general rule that institutional forms should to the extent possible follow from clear functional attributes. The primary responsibility for establishing sound national institutions rests with each country and its leadership. However, for each specific sector and country, there are an array of choices regarding the specific form institutions might take. In establishing and adapting institutions, countries need to take into account their circumstances, their history and their development objectives.

IV. Key features of effective institutional change

12. While each country needs to develop institutions to meet its specific needs for achieving the development goals and adapting to and managing integration in the global economy, there are certain key features that are essential for building effective institutions. Drawing up an exhaustive list of these features is neither possible nor necessary; instead, some illustrative examples are given in the present section.

13. *Promoting inclusiveness.* Good institutions promote social, political and economic inclusiveness. This is the basis upon which they become generally acceptable to the whole society. This test can be met only when there is wide participation in decisions about institutional development to ensure that the interests of various constituencies are met in a balanced manner. The ability of a country to allow, generate, coordinate and balance diverse opinions and interests is testimony to successful institutional development. Institutions that coordinate and mediate conflicting interests are important for creating an atmosphere that is conducive to stability and broad-based economic growth and development. This also has direct impact on the distribution of benefits. The test of inclusiveness is also applicable at the global level. In the context of achieving the development goals and integrating into the world economy, institutions must evolve and respond to the concerns and interests of all countries.

14. *Enhancing accountability and transparency.* Accountability and transparency are the guarantors of institutional objectivity and impartiality. This also checks the tendency of entrenched interests to resist institutional changes that respond to emerging challenges or promote equity and sustainable development if those changes threaten their position. One effective tool for enhancing accountability and transparency is performance reporting, as it can help various actors understand the impact of various options for action. Another comprises effective checks and balances existing within institutional structures and in the environment in which they function.

15. *Innovation and learning.* Good institutions should facilitate smooth adjustment to changing circumstances in a country and in the external environment. Without inbuilt ability to learn and adapt, institutions can become irrelevant in changing situations and thus produce unacceptable outcomes. Institutional change is a painstaking and costly process. Despite the costs and uncertainty involved, however, changes in the economic and social environment require countries to adapt their institutions if they wish to minimize adverse outcomes and generate maximum

benefits for their people. This dynamism and agility are also required at the global level.

16. *Complementarity*. The institutions should complement each other. The effective functioning of one institution usually requires the proper functioning of others. For example, proper functioning of a formal institution like a constitution depends crucially on informal institution like social norms. Without functional and structural complementarities between the institutions dealing with economic, social and environmental areas, the goals of poverty eradication and sustainable development are difficult to achieve.

17. Institutional innovation should, to the extent possible, build on existing institutions to ensure that changes are understood and stand a better chance of being accepted by the widest possible number of strata of society.

18. Institutions are as good as the people who design, build and operate them. Therefore, it is essential that their design, while giving due attention to institution building and change, take into account the human capacity for implementation. Each institution has unique characteristics that determine its viability and effectiveness. Institutional capacity includes, but is not limited to, the knowledge, skills and, above all, the commitment of all the stakeholders — particularly, the individuals responsible for managing the institutions' affairs as well as all its beneficiaries.

19. Human capital affects the quality of the rules that govern market transactions and the enforcement of these rules. Literacy levels and technical skills vary greatly across and within countries, influencing the ease of use of formal institutions by the public. The rules and organizations that govern markets have to allow the relevant market actors to use them easily. This argument holds within countries as well, for example, across poorer rural and richer urban areas.

20. The usefulness of institutions also depends on the capability of their administrators. Judges untrained in corporate law and accountancy, for instance, may not be the best arbiters in bankruptcy cases. Successful institution-builders have had either to tailor institutions to prevailing administrative capacity (using, for example, simpler bankruptcy rules) or to supplement institution-building with a strong focus on concurrently developing technical expertise for administrators (encompassing skills in areas ranging from accountancy to regulatory economics).

21. In turn, the effectiveness of institutions also depends on the system of checks and balances that should promote their accountability to the public.

V. Challenges

22. There are major challenges that all countries, particularly developing countries, face in their quest for building and strengthening institutions. The institutional forms, whether public or private, formal or informal, cannot simply be packaged and distributed as a one-size-fits-all solution for all countries. For instance, the need for a good property rights and regulatory regime to make markets work well and the requirement of good governance as the foundation for economic and social development, while generally acknowledged, neither work nor apply in the same way for all countries. Institutions therefore need to be designed to respond to the specific needs of a country and should be adjusted and upgraded as and when necessary. Developing countries need to be provided with the space and autonomy

required to experiment and come up with institutional innovations that are most appropriate to their needs. Ideally, the role of global interaction in this area ought to be to promote the interface between national institutional systems, not to harmonize institutional differences away.

23. Second, the world economy and the socio-political environment in which countries operate are constantly changing. Moreover, countries also go through various stages of development that require different types of institutions. For example, the emphasis on environmental sustainability and free markets is fairly recent and continues to generate demand for new institutional responses at the national, regional and global levels. Coping with these changes in different sectoral areas is a challenge because often the actions required are not fully understood, involve uncertainty and risks, are costly and create winners and losers.

24. Third, there are global regimes and norms that impose additional obligations on all countries. These pose special challenges to developing countries, which sometimes find their development efforts constrained by the common rules and standards of the overall global context, for example, in the areas of trade, finance, the environment and technology. These in turn strongly influence domestic institutional design and other policy responses. As a result, countries should constantly seek institutional solutions with respect to dealing with myriad emerging development challenges that most often transcend their national jurisdictions and overall capacity.

25. The process of globalization in the world economy involves, on the one hand, competing demands arising from the pursuit for example, of the goals of efficiency, equity and sustainability and, on the other hand, competition among unequal partners. It is therefore necessary to ensure, for instance, that institutions governing finance and trade not only focus on fair outcomes but also promote inclusive economic growth and sustainable development. These are challenging institutional questions that require the political will to act for a common good.

26. Finally, a crucial consideration relates to the sustainability of institutional reforms. Nothing is more detrimental to the popular enthusiasm for change than a burst of action followed by a long period of uncertainty and, eventually, few or no results. Processes of change imposed from the top, and viewed from below with deep suspicion and/or as a potential source of tension and risk, suffer this fate. It is therefore crucial to involve all stakeholders in the process as it moves from conceptualization and risk analysis to design and implementation of the key components of institutional change. The importance of systematic multi-stakeholder involvement in institution-building at all levels, therefore cannot, be overemphasized. Multi-stakeholder involvement can help to ensure system accountability and sustainability. Accountability of the national and local political systems serves as the only guaranty that the requisite institutions will get built and be sustained. The institutionalization of multi-stakeholder consultation should be promoted to ensure systematic participation and the viability and durability of institutional change. The inclusion of vulnerable groups is of particular importance because they have first hand knowledge of their needs. Ensuring that women participate in decision-making at all stages and levels on an equal footing with men is especially crucial.

VI. Managing integration and achieving sustainable development through institution-building

A. Achieving sustained economic growth

27. Developing countries' competitiveness in the global marketplace in the areas of finance, goods and services, capital and technology has become more critical to sustained economic growth. This has dictated certain changes, in particular involving institutions such as regulatory frameworks, and the role of government, the private sector and civil society. All countries have not been able to respond with equal success. It is now widely acknowledged that among the reasons why some countries are unable to reap the benefits of globalization is their lack of preparedness in terms of sound institutional capacities for sustained economic growth. The question becomes, in light of the lacklustre economic performance of several developing countries, What are the challenges that need to be met to promote economic growth? The first relates to building a strong institutional foundation for enterprises based on the rule of law, transparency and accountability, and balancing public and private interests. This requires, for instance, that market reforms and openness should respond to the needs of the whole society, thus also taking into account the goal of promoting outcomes that are socially optimal and environmentally sustainable. The second relates to ensuring that the wider global development context, in which all developing countries have to pursue their economic interests and development, is favourable. This also requires fair rules that facilitate the beneficial participation of developing countries in the global economy. The key to meeting these tests is in forging the institutional and development policy responses that are flexible enough to balance economic, social and environmental objectives and to promote cooperation among all countries in sharing the know-how needed to achieve the development goals.

28. In this regard, there is a need to continue to improve institutions in key economic areas such as macroeconomic stability, finance, trade, investment, technology, infrastructure and utilization of development assistance.

29. One of the conditions necessary for good economic performance and development is having sound macroeconomic policies in place. Sound macroeconomic policies relate to sustainable fiscal and external balances, moderate inflation, low and stable interest rates, stable exchange rates and increasingly stable asset prices. Distortions and volatility in these prices and balances can reduce growth rates and dampen investments. Ideally, policies aimed at macroeconomic stability should also emphasize economic stability and economic growth that generates employment. Sound and predictable macroeconomic policies are more feasible within the right institutional context, such as that of transparent decision-making. For instance, in the area of finance, mobilization of domestic resources, as well as their efficient utilization, can be promoted through an effective system of financial intermediation, and proper debt and equity markets, as well as a well-functioning insurance sector. This, in turn, can be facilitated by independent, transparent and accountable regulatory and supervisory frameworks suited to each country. These frameworks must be suitable for local conditions and must facilitate, rather than hinder, business transactions by not imposing unnecessary costs, increasing risks and erecting undesirable barriers to competition. Similarly,

liberalized financial markets need to be complemented by financial disclosure requirements and financial supervision.

30. The external economic environment also needs to support efforts to achieve sustained economic growth, particularly for smaller economies. Therefore, strong coordination of macroeconomic policies among the leading industrialized nations could help in stabilizing and promoting balanced growth and stability in the global economy, thereby supporting efforts to achieve high rates of economic growth that can translate into development gains.

31. Sound macroeconomic conditions need to be buttressed by good physical infrastructure, especially power, telecommunications and transport, as infrastructural weaknesses pose major impediments to investment, trade and competitiveness by increasing costs of production. Many important infrastructure facilities are natural monopolies, while others do not easily attract private capital, especially in economically weak countries. Where public finances are limited, public expenditure on infrastructure investment is often inadequate. Private-public partnerships could be promoted through arrangements whereby Governments and their development partners pave the way for infrastructure investments through pricing and concessions arrangements and other related activities. These are politically sensitive areas, as they relate to access to merit goods, that is to say, essential services such as water, energy and transport, whose provision through purely market arrangements may have unintended negative impacts on people living in poverty. Because of the limited size of many developing-country markets, regional and international cooperation in the promotion and funding of infrastructure development, and the exchange of related knowledge and research, hold great promise. For these arrangements to be credible to private investors, they must be built around practical and transparent rules and regulations. Although many developing countries are putting in place the necessary institutional frameworks, the complexity of the issues involved means that more work is required.

32. It is through the fulfilment of some of the conditions mentioned above, among others, that investments, including FDI, can be promoted and contribute to increased employment, productivity, and the transfer of technologies and knowledge as well as foster healthy competition, thereby nurturing entrepreneurship. The conditions that balance the rights and obligations of foreign investors and the host country, and functional institutions and services for promoting investments, are critical in this regard.

33. It is very difficult for a country to benefit from trading opportunities without having developed appropriate capacities to do so. Low-income developing countries, particularly least developed countries, also face numerous supply-side constraints. Until these constraints are overcome, least developed countries cannot benefit much from export opportunities. Countries need to build their productive and trade capacities, including those addressing agricultural and agro-industrial development. Governments can play a role in helping to identify and nurture new areas of activity in which a country has or can develop a comparative advantage. However, the capacity for international trade can become an instrument for achieving the internationally agreed development goals only if the global trading system is development-oriented. A universal, rule-based and equitable trading system that allows developing countries to take full advantage of international trade

is key to making trade an instrument of development. It also determines the success with which productive capacity can be built.

34. The ability to generate and utilize technology is an important ingredient for pursuing development goals. Most developing countries do not have or cannot afford the institutional arrangements required to absorb and generate technologies, such as institutions for research and development, and the incentive structures to overcome limited market size. Unfortunately, the lack of viable markets in the developing world offers no incentive for private companies to develop technologies suited to the needs of developing countries. They are also faced with restrictive regimes like that for trade-related aspects of intellectual property rights, which effectively limit access to technologies needed for beneficial integration into the global economy. These countries need to develop institutional frameworks that facilitate and nurture technological development. This should also be supported by global institutional responses. The question of access needs to be addressed by making existing regimes more development-friendly; and there are several ways to overcome the problem of generating relevant technologies. Innovative schemes to subsidize technological adaptation and generation merit consideration as do Governments' commitment to contractually reward the creation of such new technologies for developing countries with guaranteed purchase agreements.[1] In this way, they would ensure minimum financial returns on private research undertaken for the benefit of developing countries. These are the kinds of institutional and policy innovations required to fully utilize the potential of market forces for achieving the development goals.

35. Migration is another issue that needs greater attention. The increase in cross-border movements of labour is a hallmark of globalization that has both benefits and costs. In the absence of a more orderly framework for migration beyond the International Labour Organization (ILO) conventions, trafficking in human beings, especially women and children, mistreatment of refugees and asylum-seekers, and a general violation of the rights of migrants have become rampant. Some global arrangement for managing migration would promote better linkages between migrants and countries of destination as well as countries of origin and thereby facilitate better circulation of skills and resources. This is one area that requires a major institutional shift, otherwise the issues might become unmanageable. The report of the Secretary-General to the General Assembly at its sixtieth session on human resources development (A/60/318) offers a more in-depth discussion of possible institutional innovations in this area.

36. International development assistance is crucial to the achievement of the United Nations development agenda, including the Millennium Development Goals. However, aid delivery and its utilization remain a major challenge. Effective aid utilization requires concerted efforts to understand its interaction with the national economy (see box 2). The quality of institutions of developing countries is key to enhancing the absorptive and development management capacity of recipient countries. Aid can also become a major input for fostering institutional change.

Box 2

Mozambique's performance assessment framework for donors

The Government of Mozambique and donors have agreed to establish a performance assessment framework for the donor community. The objective is to monitor donor behaviour on commitments, expose non-compliance and weaknesses to peer pressure, and strengthen donor accountability to government. Key features of this arrangement determine that, inter alia,

- Donors will identify the indicators to be assessed, which will subsequently be discussed with and vetted by the Government.
- Donor performance will be assessed by an independent team and subject to periodic discussion by the Government and donor peers.
- The donor performance assessment framework will be linked to an action plan and time frame for implementation.
- Annual donor performance reports will be released publicly.
- The framework will be continuously adapted based on collective and individual donor assessments.

Source: Richard Gerster and Alan Harding, "Baseline survey on programme and partners' performance in 2003", report to the G-15 Programme and Partners and Government of Mozambique, 2004. See also *Global Monitoring Report, 2005: Millennium Development Goals: From Consensus to Momentum* (Washington, D.C., World Bank, 2005), box 5.6.

37. While there have been some encouraging developments with regard to achieving the agreed ODA targets, globalization has also opened opportunities for exploring innovative ways of providing development finance. These institutional innovations can go a long way towards ensuring the timely realization of development goals. Innovative funding arrangements, such as the proposed International Finance Facility designed to front-load ODA disbursement, are institutional initiatives that could benefit from an environment of improved aid effectiveness.

38. The foregoing discussion points to fundamental institutional gaps at the global level. First, there is a need to realign the norms and rules that set equal standards of competition, financial regulations and sustainability expectations among unequal partners. The principles of special and differential treatment and transitional provisions applied flexibly would yield significant development gains for developing countries. Second, the voice and participation of developing countries in global decision-making and norm-setting institutions must be strengthened. Discussions on these issues have started in the Bretton Woods institutions, but progress remains slow. There is also a need to make global economic governance more open, transparent and representative of the emerging realities. Developing countries should secure appropriate representation not only in the Bretton Woods institutions but also in arrangements like the Bank for International Settlements, the Financial Stability Forum and the Basel Committee on Banking Supervision. Such representation would ensure that developing countries concerns are clearly

understood. Respecting the diversity of institutional forms should be the central plank of the global governance arrangements. Lastly, the interests championed by countries in different multilateral forums should be more consistent with their public commitment to development as reflected in the internationally agreed development goals.

B. Meeting basic needs and promoting equity

39. Social development is at the centre of efforts to make globalization work for everyone. It is about the well-being, dignity and aspirations of peoples. These aspirations have been captured in the internationally agreed development goals, as contained in the outcomes of the United Nations conferences and summits. They cover a whole range of issues arising from the commitments on human rights, education, health, gender equality, eradication of poverty and hunger, social integration and access to productive employment. This development agenda provides a policy framework that can make the process of integration a beneficial one for every country, as it deals with the development of societies.

40. In terms of actual achievements of specific goals, however, the track record among developing countries as a whole has been mixed, with the greatest shortfall in Africa. One of the reasons for the lack of progress is the inherent tension between the achievement of social development objectives and an economic context increasingly determined by selective liberalization, the defining feature of globalization. For instance, one of the characteristics of the world economy, which is likely related to economic liberalization, has been a general increase in income inequality between developed and developing countries, and within many developed and developing countries. In the process, capital has gained at the expense of labour. Women have been hit particularly hard in a system that does not place an adequate premium on non-market contributions to development. Developed countries have also faced the challenges of social disruption; but in most cases, the institutionalization of social welfare and social protection systems has been very successful in ensuring that marginalized people have access to minimum basic requirements for a dignified existence. However, many people in poor countries have no such social protection systems.

41. The reality of global integration has therefore been accompanied by a growing social institutional gap, especially in such critical services as education, health, water, sanitation and housing, where the key dilemma of balancing the market criterion of profitability and the social goal of equity is coming to dominate the institutional debate. There is a need to revisit and redesign the pillars of social inclusion and integration whose strength has been eroded in the unfolding global socio-economic dynamics of the last two decades. This redesigning process has to be undertaken by each and every country in conformity with its own circumstances. A more detailed examination of a few key areas can help illustrate this need.

42. Health is a key social development goal and is essential for economic growth and development. The provision of free, heavily subsidized or publicly funded health services is an important instrument of social policy and equity in many, if not all, countries. Ensuring people living in extreme poverty some modicum of access to health services allows them to live productive lives. That there has been a deterioration of accessible health services as well as of available trained personnel

in many developing countries, has been, in several cases, the result of migration of skilled personnel to developed countries further compounded by the spread of HIV/AIDS and the resurgence of malaria and tuberculosis. The Millennium Development Goals of having reduced by two thirds the under-five mortality rate and by three quarters the maternal mortality ratio, and to have halted and begun to reverse the spread of HIV/AIDS and the incidence of malaria and major diseases, all by 2015, will require major investments in rebuilding and strengthening health systems.

43. As a service sector, health services are increasingly open to international trade. The monumental task of improving health systems and infrastructure will therefore require new flexible institutional responses that allow the contribution of the private and public sectors to support each other, while taking into account the question of access for the poor. Proposals to remove user fees in basic health service provision and to provide free mosquito nets are encouraging steps towards restoring pro-poor health service provision. However, these need to be grounded in strong institutions. Therefore, in the long run, health systems in developing countries need to be strengthened. They will also require enhanced investment in human capital. Appropriate action at the global level is also needed to support initiatives to strengthen institutions and invest in human resources in the health sector.

44. An important health-related challenge is to provide access to affordable medicines. Given the primary role of the private sector in producing medicines and undertaking research as well as the global rules that govern access to these medicines, innovative institutional responses are required to address this issue. One such approach is to promote partnerships between the private and public sectors in supporting health services delivery in developing countries and in research and development, especially for the under funded diseases that afflict the poor.

45. Education and training are another fundamental tool in poverty eradication, social inclusion and the transition to higher productivity, since skills acquisition is vital to productive and remunerative employment. Moreover, education is the foundation upon which a knowledge and information society is built. The quality and depth of education also matter as a basis for global competitiveness and inclusion.

46. Educational service provision has also become of interest to private sector investment. Many developing countries find themselves in a dilemma where increasing privatization of the sector entails large social costs that can threaten political stability. For example, despite the growing number of private schools nationwide, public schools still account for most coverage of basic education in India. Therefore, enhancing the quality of publicly provided education is as important as addressing equity concerns in growing privatization of education. In this regard, programmes to fund universal public primary education, supported by donor partners in many developing countries, should be complemented by initiatives to introduce and mainstream quality and accessible education at all levels.

47. Employment is an essential element for a dignified life and should form an essential part of the policy framework for integration. The generation of employment should be at the heart of macroeconomic and social policies. Governments should ensure that efforts by enterprises to cut costs do not involve the exploitation of workers. While this should be the purpose of labour laws, due caution must be exercised in order not to stifle the legitimate growth of businesses

and job creation. The social protection of workers through systems that suit local conditions is part of an enabling institutional base in this area. In addition, the full potential of informal sector and of small and medium-sized enterprises should be promoted with the aim of unleashing their full entrepreneurial capacity, including through innovative methods for conferring property rights, and affording more universal access to credit. The needs of women and other vulnerable groups should be emphasized in connection with efforts to promote inclusive finance.

C. Promoting environmental sustainability

48. Globalization adds multifaceted challenges and opportunities to the pursuit of environmental sustainability and sustainable development. The recognition of the commonality of environmental concerns has led to the proliferation of multilateral environmental agreements, which have to be implemented by all parties. This has placed an increasing burden on many developing countries because complying with the norms and standards set in these agreements often involves costly governmental structures and reporting mechanisms. Moreover, the need to ensure that multilateral environmental agreements and other objectives such as technology, trade, investment and resources mobilization are mutually supportive has sometimes gone unmet.

49. Often, incentives competition for the scarce capital flows that are available lower the technological content and other benefits of FDI, thereby exacerbating environmental degradation.[2] The rapid expansion of global commerce in natural resources such as timber, minerals, and other raw materials is putting ecosystems in some of the most biologically diverse places on earth increasingly under threat. Frequently, markets fail to recognize the full value of natural ecosystems and there are no institutional mechanisms to reconcile the profit motive and the currently uncompensated free services provided especially by developing countries.

50. A related problem is that of the production subsidies and protection, especially for agriculture in developed countries, that are undermining food production and security and exports of developing countries. This promotes an overuse of water, fertilizer and pesticides in developed countries and limits the scope for profitable modernization of agriculture in developing countries. This explains, in part, why farmers in developing countries seem to overexploit arable land. Similar problems of overexploitation are created by subsidies to fisheries, mining and other natural resource-based economic sectors. The end of such price distorting subsidies and support in developed countries, which lead to misallocation of resources and environmental damage, should be a key development outcome of the Doha Round of multilateral trade negotiations.

51. International watersheds, fisheries, acid rain, air pollution and climate change are transboundary environmental challenges that require cooperation between countries in order to be addressed effectively. Where political boundaries do not coincide with shared ecosystems, the promotion of regional institutions for the management of transboundary ecosystems offers vast mutual economic and environmental benefits.

52. The development of innovative funding sources and markets that internalize global environmental costs and reward benefits can provide additional financial resources for funding sustainable development. The Global Environment Facility,

the Multilateral Fund of the Montreal Protocol on Substances that Deplete the Ozone Layer,[3] the Clean Development Mechanism, emissions trading schemes, and joint implementation under the Kyoto Protocol[4] to the United Nations Framework Convention on Climate Change[5] are important institutional innovations in funding global environmental investments. Several longer-term innovative ideas for financing development to complement ODA, including debt-for-nature swaps, could be explored. While the international community has subscribed to the principle of common, but differentiated responsibilities, the institutional gap in the implementation process, relating to the provision of adequate financial resources, access to dedicated financing mechanisms, better scientific understanding of the issues, and stronger mechanisms to monitor and ensure implementation, remains to be bridged.

53. The sustainability of the natural environment has important implications for the well-being of all peoples, and for the implementation of the United Nations development agenda, including the Millennium Development Goals. When people living in poverty overexploit their natural resources and the ecosystem to survive, they cause environmental damage. Degraded natural resources and ecosystems entrench poverty and undermine livelihoods, thereby creating vulnerability. In addition, unsustainable production and consumption patterns, particularly in developed countries, increase environmental vulnerabilities in all countries through increased water usage, biodiversity loss, air pollution and greenhouse gas emissions/climate change. Regional and global cooperation in managing and sharing resources, knowledge and technology is central to addressing these challenges and requires institutional response and support. Examples include institutional arrangements concerning international watercourses and lakes, such as the Aral Sea basin, the Danube River basin and Lake Victoria, that address such issues as water access and quality and ecosystem management through cooperation among riparian States.

54. The transition from low to high productivity and to cleaner production that is environmentally sustainable is especially difficult. The major impediments to this transition are a combination of internal and external factors such as small internal markets, and poor access to technology and external markets. The result has been overexploitation of natural resources with adverse effects such as deforestation, desertification, groundwater depletion, pollution and endangerment of biological diversity. Solutions to these problems often lie beyond national jurisdictions and strategies. The global regimes that govern technology and ecosystem management need to promote rules and norms that are pro-development and give developing countries the leeway to move to higher productivity and sustainable development.

55. Although the spillover effects of major environmental concerns dictate global and regional approaches, most tangible actions remain national. In most countries, separate ministries are responsible for managing different aspects of ecosystems, such as the environment, lands, forestry and fisheries. In most cases, environmental sustainability is not part of the mandate of many existing regulatory bodies, like independent regulators of privatized water and power systems. In such cases, they may not necessarily promote access, ensure sustainable use of natural resources or fully incorporate environmental impact considerations. Although political leadership remains important in the process of adopting institutional frameworks for sustainable development, each country will configure the arrangements that best respond to its unique demands.

56. The development of integrated approaches, though the optimal choice, has been very limited because of the inherent tensions between the quest for survival and development, and environmental sustainability objectives. To ensure that the long-term benefits of environmental sustainability are taken into consideration at the policy design stage, a careful balance has to be established among social, economic and environmental objectives. These tensions should be tackled head-on at the planning stage.

VII. Conclusions and recommendations

57. The need for institutional development and adaptation is an enduring challenge. A limited view of institutional reforms — especially one that focuses only on the role of markets and securing private property rights, without due attention to a holistic and optimal development outcome from the point of view of society — may be inadequate. Whereas the role of markets is critical, it needs to be seen within the context of broader societal goals of social equity and environmental sustainability. The principal challenge facing developing countries is to develop sound institutional foundations for the effective and efficient functioning of markets within the framework of their social and environmental objectives. The supportive institutional arrangements may vary, given the level of development and specific national and regional contexts. This notwithstanding, empirical evidence shows that institution building and strengthening are vital in the quest of developing countries for sustainable development and beneficial integration in the global economy. A central objective should be to ensure that institutional reforms respond to the needs of the poor as a key priority in poverty reduction strategies and, indeed, in overall strategies to promote more rapid, broad-based and sustainable growth and development.

58. Strong and widely accepted institutions — rules and norms and the organizations, both private and public and formal and informal, embodying them — that respond to the needs and priorities of poor groups, especially the rural poor and women, are essential for rapid poverty reduction and development. Weak, ineffective, corrupt, narrowly based or captive institutions create uncertainty and unfairness, discourage saving and investment, and lower growth rates.

59. Market-enabling institutions are fairly well known. Why they do not work in certain countries relates to their weaknesses in terms of human capital, social base and political commitment to rule-based approaches. A considerable amount of reconceptualizing and situating them in different contexts constitute a challenge that must be tackled in the framework of the development strategies of all developing countries.

60. There has been a considerable advance in the understanding of the relationship between economic development and environmental sustainability. These are areas where acting nationally is no longer sufficient. Reconciling the development aspirations of developing countries and the needs of environment sustainability requires global cooperation. In spite of the many multilateral environmental agreements, an institutional gap remains in the implementation machinery which requires urgent action.

61. Finally, changes are needed to make globalization work for all. This requires reshaping the rules that govern trade, finance and technology transfer and filling the

institutional gap in areas like investment and migration, and giving developing countries a more effective voice and the means to participate in making the global decisions that affect them. First, there is a need to realign the norms and rules that set fairer standards for competition and financial and environmental regulations among unequal partners. The principles of special and differential treatment and transitional provisions applied flexibly would yield vast development gains for developing countries. Second, the voice and participation of developing countries in global decision-making and norm-setting institutions must be strengthened. Discussions on this issue have started in the Bretton Woods institutions, but progress remains slow. Furthermore, in other policymaking and standard-setting bodies, such as the Bank for International Settlements, the Financial Stability Forum, and the Basel Committee on Banking Supervision, no formal participation of developing countries exists today. Recent efforts to involve developing countries through informal arrangements in such exclusive international groupings, although welcome, need to be established on a more formal basis.

62. **The following recommendations merit attention:**

(a) **Developing countries should consider putting institutional development high among their development priorities, particularly in sectors critical to the achievement of the international development goals. Such strategies should ensure the development of institutions that are flexible and responsive to changing needs;**

(b) **Governments should design their policies and regulatory regimes and agencies so as to ensure that they flexibly balance social, economic and environmental objectives. This in turn requires a transparent, participatory approach involving all stakeholders;**

(c) **The private sector, civil society and public-private partnerships have a crucial role in delivering development within the new dynamics of interdependence. Therefore, the development of flexible regulatory frameworks governing arrangements among Governments, the private sector and consumers deserves high priority;**

(d) **Efforts to expand productive employment and decent work should include measures to recognize, support and regulate the informal economy with rules and arrangements that enable, rather than constrain, the sector;**

(e) **Countries may consider establishing and/or strengthening regional and interregional cooperation arrangements as a way of pooling their resources and utilizing regional synergies in the areas of the environment, resource management, trade and knowledge as well as information-sharing on major development issues;**

(f) **A global sustained capacity and institutional development effort is required, supported by United Nations system organizations, the Bretton Woods institutions and the World Trade Organization, and all other relevant international organizations, so as to promote the dissemination of institutional innovations in their areas of competence that can be adapted by developing countries in accordance with their needs and priorities. To this end, national institutional development should be a central element of development support to developing countries;**

(g) Global institutional challenges in the areas of trade, finance, investment and technology need to be reviewed with the aim of promoting pro-development global rules and norms that give developing countries a better chance of integrating beneficially in the global economy. This task of generating the understanding and political will to act on such an agenda could be undertaken, initially using existing mechanisms for dialogue on policy and institutional coherence;

(h) Consideration could be given to the organization of expert-level meetings for in-depth analysis and review of the key national, regional and global institutional questions raised in this report (though the analysis and review need not be limited to those questions) as a way of bringing greater clarity to the complex challenges of building inclusive, accountable and dynamic institutions that are pro-poor and pro-development.

Notes

[1] Nancy Birdsall, Dani Rodrik, and Arvind Subramanian, "How to help poor countries", *Foreign Affairs*, vol. 84, No. 4 (July/August 2005).

[2] See World Commission on the Social Dimension of Globalization, *A Fair Globalization: Creating Opportunities for All* (Geneva, International Labour Office, 2004). Also available from http://www.ilo.org/public/english/wcsdg/docs/report.pdf.

[3] United Nations, *Treaty Series*, vol. 1522, No. 26369.

[4] FCCC/CP/1997/7/Add.1, decision 1/CP.3, annex.

[5] United Nations, *Treaty Series*, vol. 1771, No. 30822.